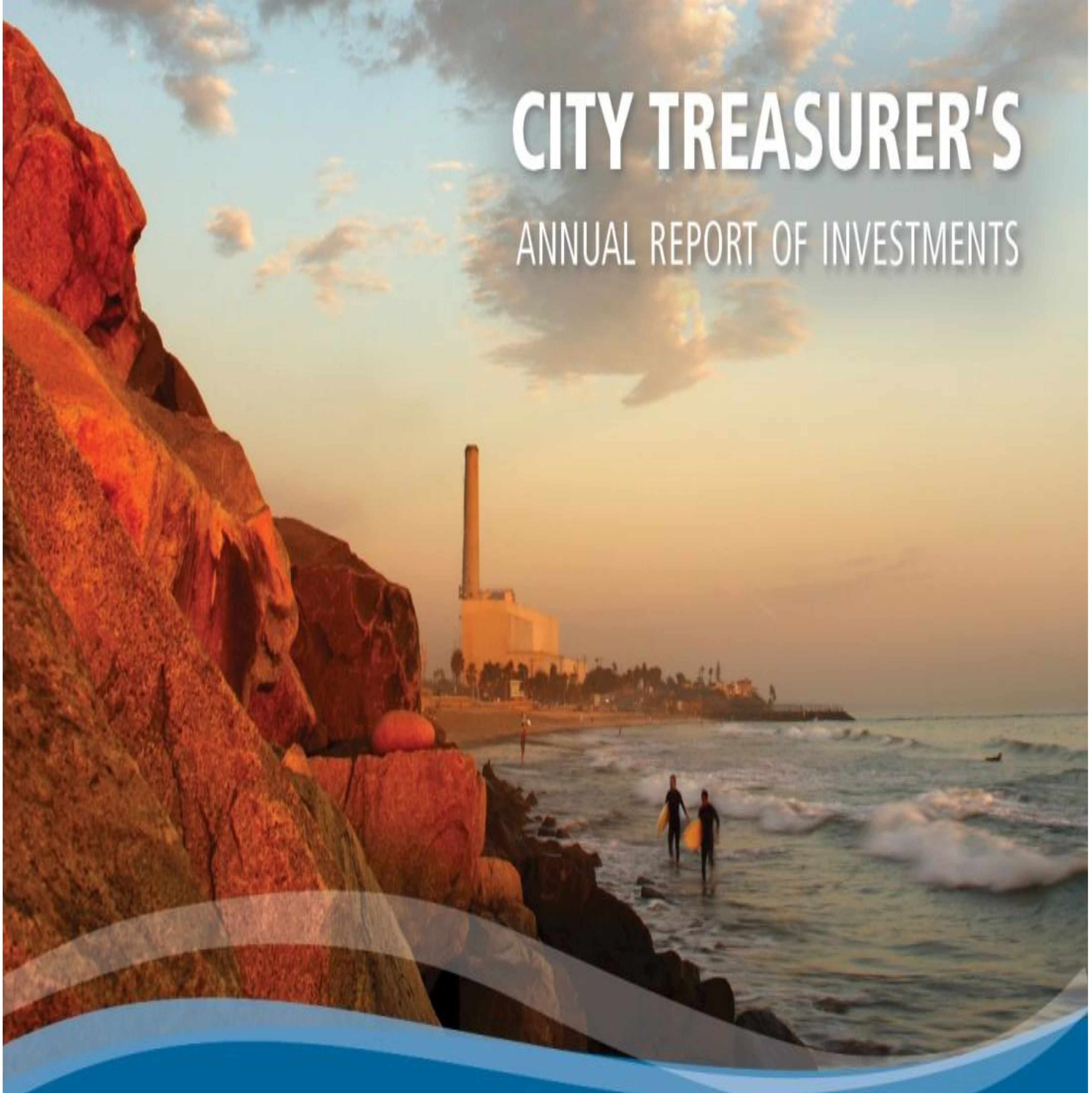
CITY TREASURER'S

ANNUAL REPORT OF INVESTMENTS



Fiscal Year Ended 6/30/11
(FY 10-11)

CITY OF
CARLSBAD

CITY OF
CARLSBAD
Office of the Treasurer

December 2011

Honorable Mayor, City Council,
And Residents of the City of Carlsbad
1200 Carlsbad Village Drive
Carlsbad, CA 92008

City Treasurer Letter of Transmittal
2010-2011 Annual Report of Investments

I am pleased to present the Annual Report of Investments for the City of Carlsbad for the fiscal year ended June 30, 2011 (FY 10-11). The report is intended to provide reliable information as a basis for reviewing portfolio performance and making management decisions. It also provides an archival reference.

The City Treasurer is charged with the design of an effective cash management and investment program for the City of Carlsbad and all of its agencies. Among other activities, this includes arranging for banking services; forecasting all cash receipts and expenditures; investing all inactive cash; managing investment risk exposures; and reporting all investment activities.

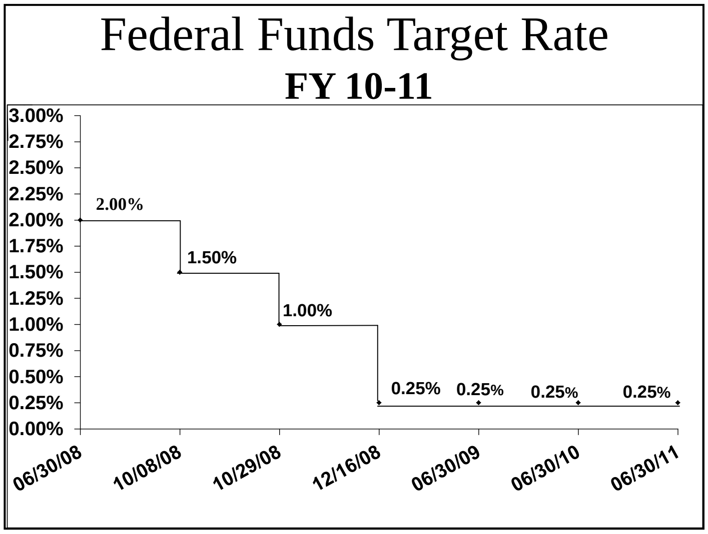
This report summarizes and analyzes the activities of the investment portfolio for the fiscal year. Total portfolio assets, investment portfolio relative to total city assets, source of portfolio assets, asset allocations, yield achieved, unrealized gains and losses, and cash revenues are presented. To give perspectives to these measurements, a summary of movements in global and U.S. economic, as well as market interest rates are provided for the fiscal year ended June 30, 2011. Comparisons are also made with the preceding fiscal years. Finally, a statement is offered regarding the prospects for the fiscal year 2011-2012.

Jim Comstock

Jim Comstock
City Treasurer

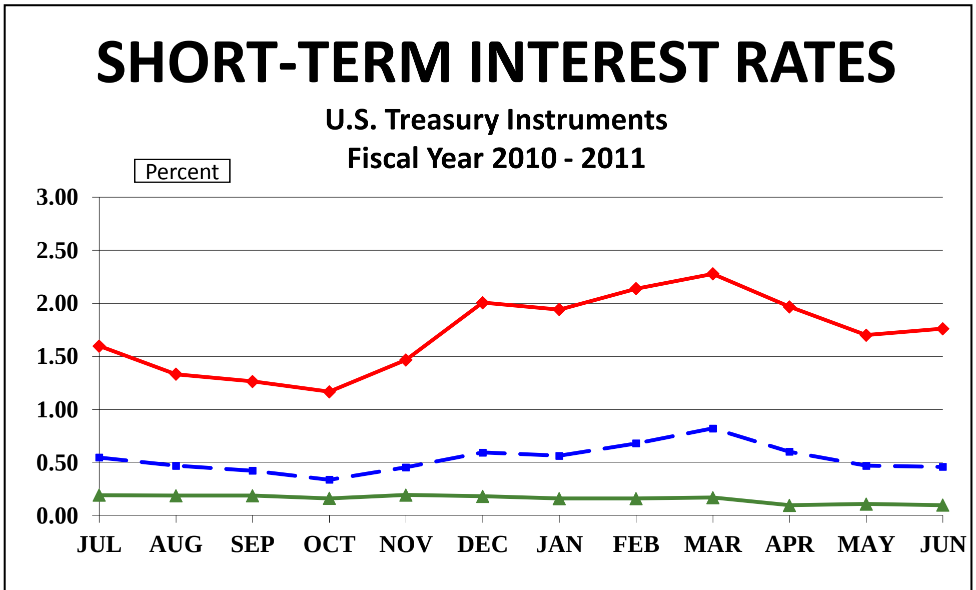
CITY TREASURER
ANNUAL REPORT OF INVESTMENT PORTFOLIO FOR THE FISCAL YEAR ENDED JUNE 30, 2011

FY10-11 MARKET REVIEW

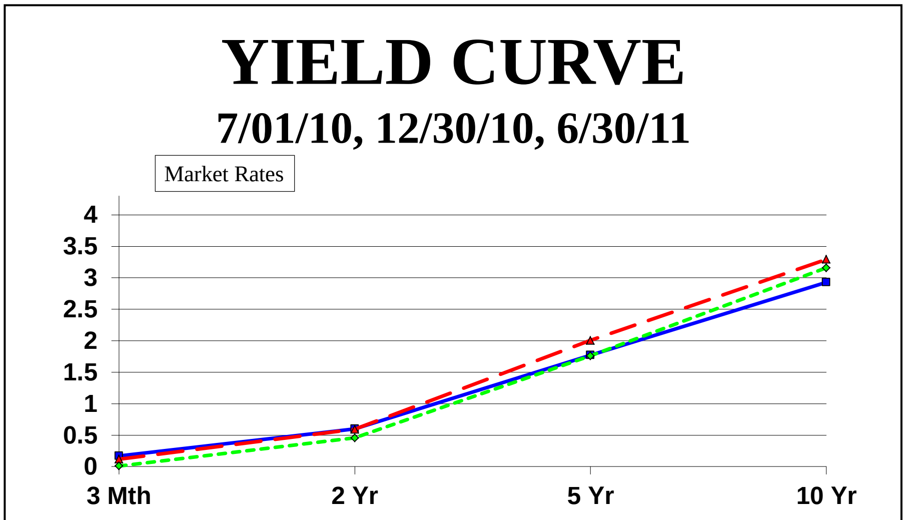


Federal funds rate is a key money market rate that correlates with rates of other short term credit arrangements. It is the interest rate that banks charge each other for overnight loans. In fiscal year 10-11, the Federal Reserve maintained the federal funds rate at .25%.

Changes in short-term market interest rates are usually affected by the actions of the Federal Reserve.
Six-month and two year market rates decreased over the course of the fiscal year. The five year rate increased slightly.



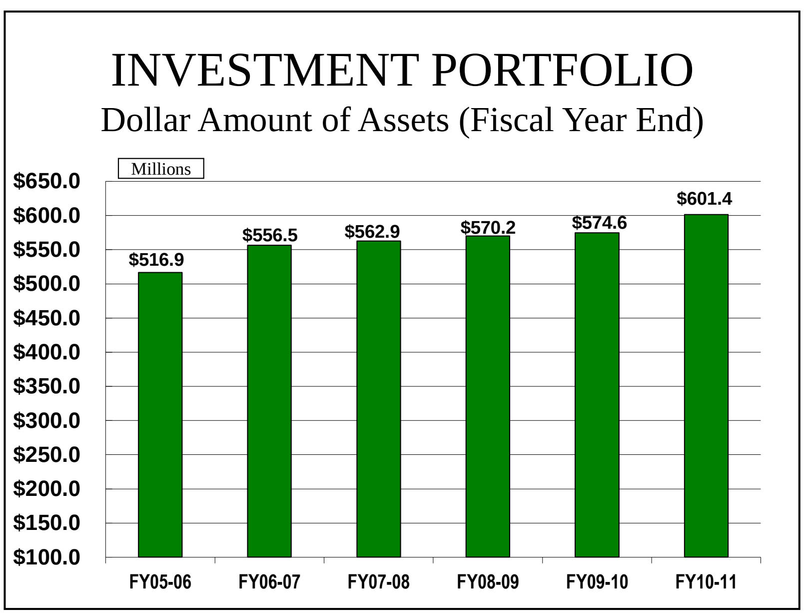
	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN
Five Year	1.60	1.33	1.26	1.17	1.47	2.01	1.94	2.14	2.28	1.97	1.70	1.76
Two Year	.55	.47	.42	.34	.45	.59	.56	.68	.82	.60	.47	.46
6 Month	.19	.19	.19	.16	.19	.18	.16	.16	.17	.10	.11	.10



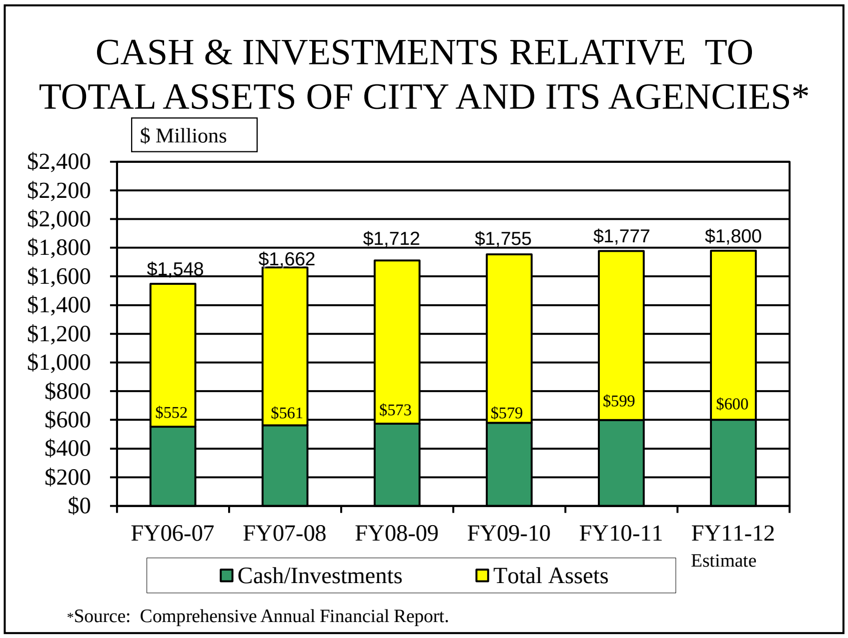
	3 Mth	2 Yr	5 Yr	10 Yr
07/01/2010	.170	.601	1.773	2.931
12/31/2010	.120	.593	2.006	3.294
06/30/2011	.010	.458	1.761	3.160

The yield curve is a graphic presentation of the difference between short-term and longer-term interest rates of U.S. Treasury instruments on a given day. Financial analysts use it to assess the market's expectation of recession or inflation. The normal shape of the yield curve has a moderately upward slope, with short-term rates lower than longer-term rates. If the upward slope steepens, the financial markets believe inflation may occur. An inverted yield curve is when short-term market rates are greater than longer-term market rates. An inverted curve indicates that the financial markets expect a slower economy, if not a recession. At fiscal year end the yield curve showed a relatively moderate upward slope.

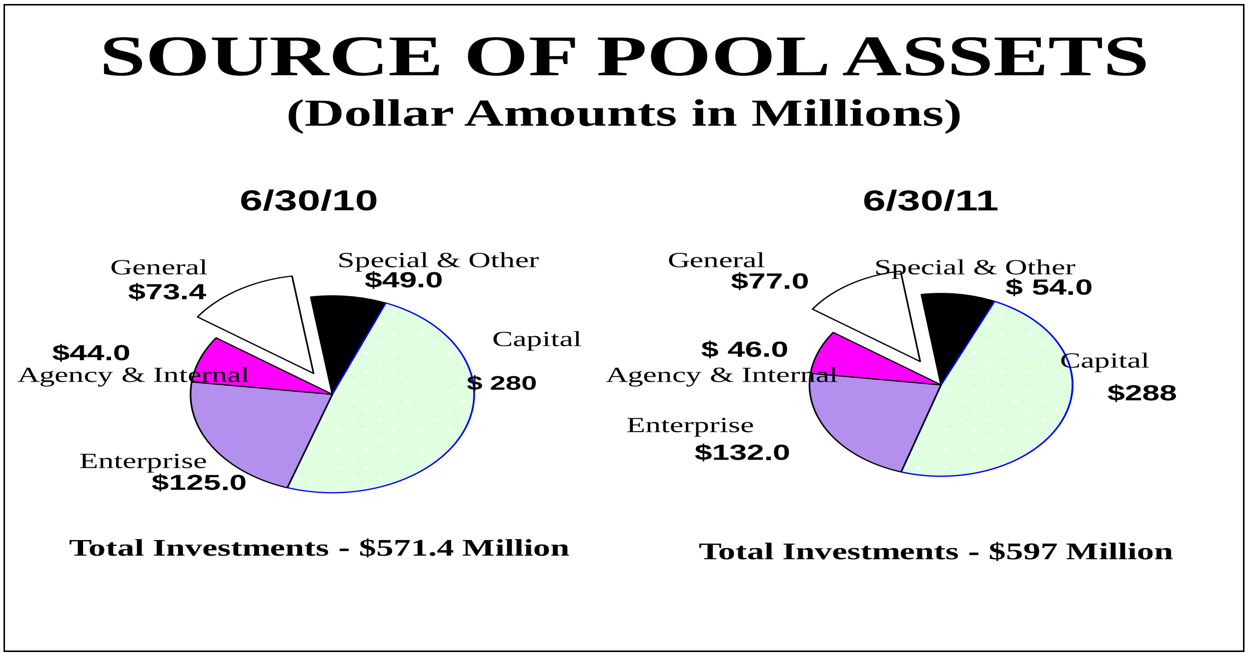
PORTFOLIO ANALYSIS



Total assets in the investment portfolio, based on cost, stood at $601.4 million at the end of the fiscal year; a $26.8 million increase. This increase includes interest earned, loan proceeds, and revenues in excess of expenses.

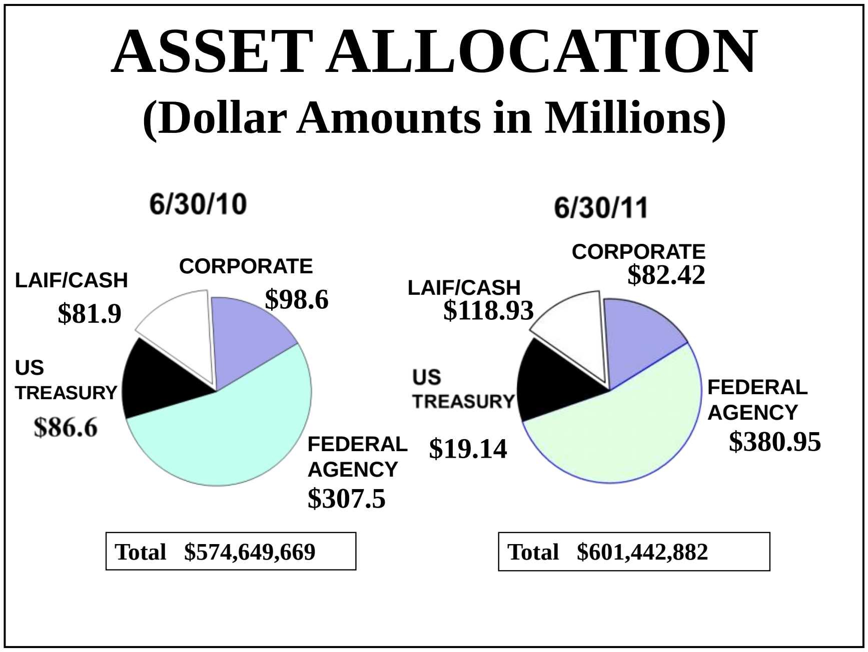


The City publishes a Comprehensive Annual Financial Report (CAFR) at the end of each fiscal year. Among other information, CAFR presents a balance sheet showing the total assets owned by the City and all its agencies. At the end of FY 10-11, cash and investments managed by the City Treasurer represent 34% of all assets reported by the City and its agencies.

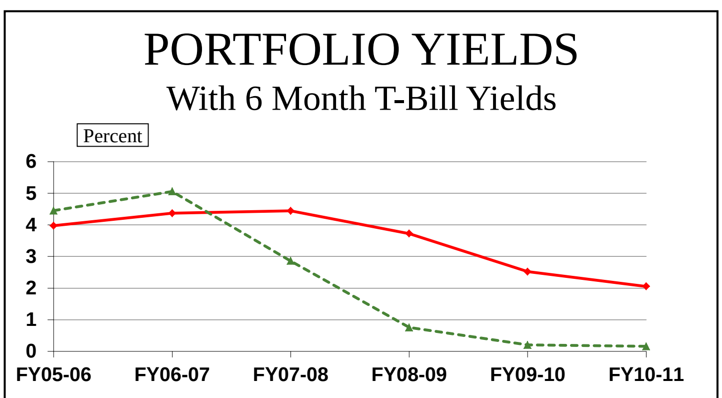


The portfolio is an internal investment pool calculated that uses the inactive cash from the various funds of all City agencies, including the City, the Water District, and the Redevelopment Agency. The top three sources of portfolio assets calculated at amortized costs are the Capital Projects fund 48%, the Enterprise fund 22%, and the General fund 13%. Together, these three funds account for 83% of total portfolio assets.

Investments are made in financial instruments authorized by the City's Investment Policy and the California State Government Code. With the exception of bank deposits and deposits in the California State Local Agency Investment Fund (LAIF), all investments are in fixed-income instruments with known maturity dates.



On June 30, 2011, 63% of portfolio assets were invested in federal agencies, 14% in corporate notes, 3% in US Treasuries and 20% in LAIF and cash. The allocation of assets to federal agencies and LAIF increased while the allocation to US Treasuries and corporate notes decreased from the previous year. Within the asset category of federal treasuries and agencies, investments in Treasuries, Federal Home Loan Bank, the Federal Home Loan Mortgage Corporation*, the Federal National Mortgage Association*, and the Federal Farm Credit Bank, constituted 3%, 23%, 8%, 15, and 13% of the total portfolio, respectively. Federal agencies are creations of the U. S. Congress and include agencies and government-sponsored enterprises. * (in conservatorship by Federal Housing Financing Agency)



	FY05-06	FY06-07	FY07-08	FY08-09	FY09-10	FY10-11
Portfolio	3.98	4.37	4.45	3.72	2.52	2.06
T-Bill	4.45	5.06	2 .93	.75	.20	.16

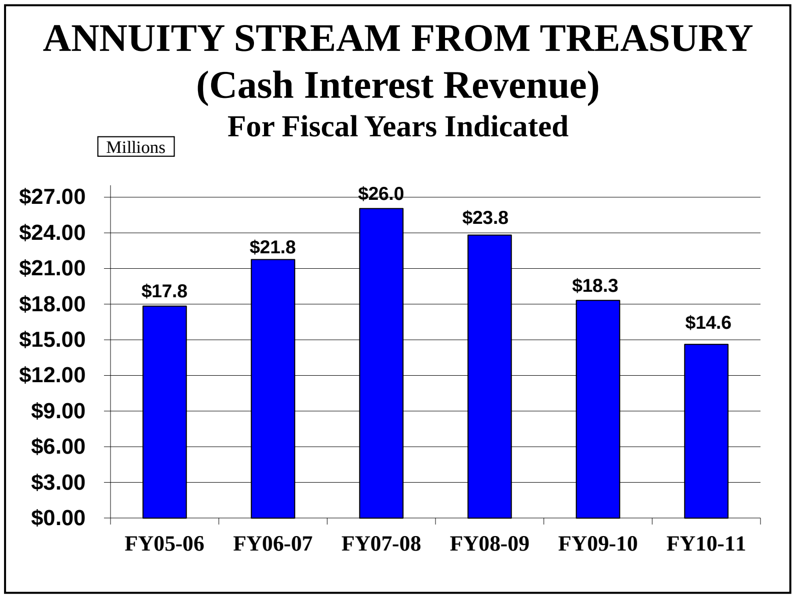
The average return of the portfolio decreased to 2.06% from 2.52% the year before. The portfolio yield is heavily influenced by changes in short-term market interest rates since 21% of total investments were required to mature within one year. The average interest rate for six-month U.S. Treasury Bills decreased to .16% from .20% the previous year.

This graph shows the percent change in value of the portfolio over the last several years. Investments gain and lose value subsequent to purchase because of changes in market interest rates. When market interest rates decrease, investments made earlier at higher rates will gain value. The reverse is true when market interest rates increase. Accountants refer to these changes in value as unrealized gains and unrealized losses; commonly referred to as paper gains and paper losses. The gain/loss is not recognized until the investment is sold. Changes in value caused by changes in market interest rates are normal and are expected.

With a buy and hold policy, an objective of the City's Investment Policy is to achieve an average market rate of return over the economic cycle. The success in achieving this objective can be approximated with having unrealized gains and losses that are relatively equal over time. Tracking and measuring unrealized gains and losses could also reveal any presence of high-risk investments in the portfolio. The changes in asset values shown in the graph indicate that portfolio investments are within the acceptable interest rate risk identified in the City's Investment Policy.

The total portfolio had a slight unrealized gain of 1.3% on June 30, 2011. If interest rates remain stable, unrealized gains and losses will remain near the 0.00%. However, a downward trend will continue if rates increase or when current investments with higher interest rates are called and reinvested at today's significantly lower market rates.

Cash income from portfolio investments represents an annuity stream of revenues from the Treasury. This annuity stream totaled $14.6 million, a decrease of $3.7 million from the previous fiscal year. Of the total cash interest revenues earned by the portfolio, approximately $1.3 million was credited to the General fund. Cash income is a function of assets in the portfolio, the market interest rates at the time of the investments, and the interest payment schedules of the issues.



FY 11-12 PREVIEW

National and international economic forces have a direct influence on the U.S. markets.

Global Economy

The global economy will be stagnant in 2012 as we move from the Great Recession to the Great Stagnation. Europe has serious debt problems that will only get worse. Applying a band aid to a massive wound does not solve the underlying problem. You can revive a heart attack victim but until you change their diet and lifestyle you have achieved nothing. The next heart attack constantly lurks around the corner. A realistic plan to reduce debt is absolutely necessary otherwise they will only muddle through the future. China, Japan and Russia will grow in 2012 and some developing countries will grow but their growth cannot carry the world economy.

U.S. Economy

Unemployment, housing challenges and debt levels continue to prevent real growth in 2012. Fears of a double dip recession have subsided. Statistically we exited the recession but many Americans do not hold that belief. As the military exits Iraq and we draw down troops in Afghanistan we will see a bump in spending and a corresponding increase in sales tax. Look back to the end of WWII and see the growth of the county as the GI's came home and spent their accumulated savings. We have a parallel but this returning military will not be of the same magnitude as WWII. The bump in spending and increase in sales tax will not be sustainable.

Inflation, for now, is in check but the inability of politicians to effectively deal with our budget issues will be a driving factor in 2012. Unless and until our Nation and our State decide to collectively get it together and devise a realistic game plan to deal with our budget problems we simply will continue to meander through the next year.

City of Carlsbad

Approximately $133 million of investments with fixed maturity dates will mature in FY 11-12. An additional $168 million will likely be called due to current low interest rates. Available proceeds from these investments will be reinvested at market rates lower than the maturing and called investments resulting in less revenue to the City. Revenue from LAIF investments will decline as LAIF's yields decline.

At the end of FY 10-11, LAIF investments had a yield of .48%, and all other investments had a yield of 2.0%. Revenues on all investments will decrease due to the low interest rate environment.

On June 30, 2011 the yield of the total portfolio averaged 2.1%. Total assets in the investment portfolio stood at $601 million at the end of FY 10-11.

APPENDICES TO ANNUAL REPORT OF INVESTMENT PORTFOLIO

APPENDIX A: RISK MANAGEMENT AND DISCLOSURE

All investments are exposed to risk of some type. The objective of risk management is to identify the risks involved and establish acceptable levels of risks that are consistent with the City's investment objectives. Risk management includes managing, measuring, monitoring, and reporting the various risks to which portfolio investments are exposed.

Portfolio investments are exposed to the following types of risks:

A. Credit risk.
    a. Custodial credit risk.
        a) Investments.
        b) Deposits.
    b. Default credit risk.
    c. Concentration credit risk.
B. Interest rate risk.
C. Event Risk.

As of June 30, 2011, the portfolio had the following investments and cash in its internal investment pool.

Investment	**Maturities**	**Market Value**	**Market Value Gain (Loss)**
U. S. agencies	July 2011 – June 2016	$401,653,000	$ 4,313,000
Corporate Notes	July 2011 – May 2016	82,883,000	1,843,000
Certif. of Deposit		--	--
LAIF		112,998,000	177,000
Sweep accounts		5,535,000	--
Cash accounts		582,000	--
Total		$603,651,000	$6,333,000

Disclosures

Custodial Credit Risk (Investments). The City uses a third party custody and safekeeping service for its investment securities. The Union Bank of California (UBC) is under contract to provide these custodial services. Custodial credit risk is the risk that the City will not be able to recover the value of its investments in the event of a UBC failure. All City investments held in custody and safekeeping by UBC are held in the name of the City and are segregated from securities owned by the bank. This is the lowest level of custodial credit risk exposure.

Custodial Credit Risk (Deposits). The City maintains cash accounts at Wells Fargo Bank (WFB) and UBC. At the conclusion of each business day, balances in these accounts are "swept" into overnight investments. These overnight investments are pooled and collateralized with either U. S. government securities or U. S. agency securities. The California Code authorizes this type of investment. A small amount of cash is not swept from the WFB checking accounts to cover checks that may be presented for payment. Amounts up to $250,000 are FDIC insured.

Default Credit Risk. Default credit risk is the risk that the issuer of the security does not pay either the interest or the principal when due. The debts of most U. S. agencies are not backed by the full faith and credit of the federal government; however, because the agencies are U. S. Government-sponsored, they carry AAA credit ratings. The default credit risk of these investments is minimal.

Unless otherwise exempted, California state code limits investments to the top three credit ratings (AAA, AA, and A). It is the City's policy, however, to limit investments to the top two credit ratings (AAA and AA). As of June 30, 2011, five investments in corporate notes had a credit rating below the AA limit. These investments were made when the credit rating were either AAA or AA. California state code and the City's Investment Policy allow the City Treasurer to determine the course of action to correct exceptions to the Policy. It is the intent of the City Treasurer to hold these investments in the portfolio until maturity unless events indicate a sale should be made. The default credit risk for corporate notes with a credit rating of single A is higher than U.S. Treasuries, federal agencies or LAIF, but is considered by the City Treasurer to be within acceptable limits for purposes of holding to maturity.

The Local Agency Investment Fund (LAIF) is an investment pool managed by the California State Treasurer. Its investments are short-term and follow the investment requirements of the State. As of June 30, 2011, the average maturity of the LAIF investments was 237 days. The State Treasurer is not required to contract for a credit rating to be assessed for LAIF. California state code section 16429.3 excludes LAIF deposits from being transferred, loaned, impounded or seized by any state agency or official.

***Concentration Credit Risk**.* Concentration credit risk is the heightened risk of potential loss when investments are concentrated in one issuer. The California state code does not identify a specific percentage that indicates when concentration risk is present for any one issuer. The state code does, however, require that total investments in medium-term corporate notes of all issuers not exceed 30% of the portfolio. As of June 30, 2011, approximately 14% of the City's total portfolio investments were in medium-term corporate notes.

For concentration of investments in any one issuer, the City's Investment Policy requires that no more than 5% of investments in corporate notes be in any one issuer. There is no similar requirement in either the state code or the City's Investment Policy for U. S. agencies. As of June 30, 2011, no investments in any one corporate issuer exceeded 5% of total portfolio investments.

***Interest Rate Risk**.* Interest rate risk is the risk that investments will lose market value because of increases in market interest rates. A rise in market interest rates will cause the market value of investments made earlier at lower interest rates to lose value. The reverse will cause a gain in market value. As of June 30, 2011, the portfolio had a 1.0% gain in market value.

The City's investment policy has adopted two means of limiting its exposure to market value losses caused by rising market interest rates: (1) Limiting total portfolio investments to a maximum modified duration of 2.2, and (2) requiring maturing investments within one year be equal to an amount that is not less than 2/3 of the current operating budget ($188,300,000). As of June 30, 2011, the modified duration of the portfolio was 1.791, within the required maximum of 2.2. Investments maturing within one year were $254,828,000, exceeding the required minimum of $125,500,000. The City's exposure to interest rate risk is within acceptable limits.

Event Risk. Event risks include the chance that something unexpected will impede the ability of an issuer of a security to meet its obligations. These types of risks are usually short in duration, but can impair the city's ability to communicate with or use banking services. Such an event could cause a delay in collecting securities which have matured. Security risks are also within this category.

APPENDIX B: PORTFOLIO ACTIVITIES FOR FISCAL YEAR ENDED JUNE 30, 2011

The City's portfolio balance increased 4.6% from $574.6 million to $601.4 million in fiscal year 2010-11. The increase of $26.8 million does little to show the volume of cash that flows in and out of the portfolio in the course of one fiscal year. The following table illustrates that the City Treasurer managed over two billion dollars of cash inflows and cash outflows which prompted investment decisions during fiscal year 2010-11.

Cash Flows:

Bond Maturities	$ 135,550,000
Bond Calls	129,120,000
Bond Sales	--
LAIF Withdrawals	202,536,000
Sweep Withdrawals	647,653,000
Interest Income	14,612,000
Bond Purchases	277,146,000
LAIF Investments	235,994,000
Sweep Investments	649,893,000
Cash Investments (net)	(46,000)
Total	$2,247,504,000